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BEFORE THE

DEPARTMENT OF TRANSPORTATION

WASHINGTON, D. C.

Joint Application of AMERICAN AIRLINES, INC. and EXECUTIVE AIRLINES, INC., FLAGSHIP AIRLINES, INC., SIMMONS AIRLINES, INC., and WINGS WEST AIRLINES, INC. (d/b/a AMERICAN EAGLE) and CANADIAN AIRLINES INTERNATIONAL LTD. and ONTARIO EXPRESS LTD. and TIME AIR INC. (d/b/a CANADIAN REGIONAL) and INTER-CANADIEN (1991) INC. under 49 USC 41308 and 41309 for approval of and antitrust immunity for commercial alliance agreement	OST-95-792 -22

JOINT REPLY OF AMERICAN AIRLINES, INC.
AND CANADIAN AIRLINES INTERNATIONAL LTD.

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February 15, 1996

BEFORE THE

DEPARTMENT OF TRANSPORTATION

WASHINGTON, D. C.

Joint Application of AMERICAN AIRLINES, INC. and EXECUTIVE AIRLINES, INC., FLAGSHIP AIRLINES, INC., SIMMONS AIRLINES, INC., and WINGS WEST AIRLINES, INC. (d/b/a AMERICAN EAGLE) and CANADIAN AIRLINES INTERNATIONAL LTD. and **ONTARIO EXPRESS LTD.** and TIME AIR INC. (d/b/a CANADIAN REGIONAL) and INTER-CANADIEN (1991) INC. under 49 USC 41308 and 41309 for approval of and antitrust immunity for commercial alliance agreement	OST-95-792

JOINT REPLY OF AMERICAN AIRLINES, INC.
AND CANADIAN AIRLINES INTERNATIONAL LTD.

American Airlines, Inc. and Canadian Airlines International Ltd. hereby jointly reply to the answers submitted on February 5, 1996 by Delta Air Lines, Inc., Northwest Airlines, Inc., United Air Lines, Inc., Air Canada, and the International Air Transport Association. As we show below, none of the commenters has advanced any compelling reason to defer or deny approval of the joint application, which should be granted on an expedited basis so that the public may begin enjoying the pro-competitive and pro-consumer benefits that American and Canadian will bring to the transborder market under their proposed commercial alliance agreement.

1. THE HISTORIC U.S.-CANADA AIR TRANSPORT AGREEMENT HAS ALL THE CRITICAL ATTRIBUTES OF AN OPEN SKIES AGREEMENT, AND HAS PRODUCED THE MOST COMPETITIVE INTERNATIONAL AIR TRANSPORTATION MARKET IN THE WORLD.

United, Northwest, and Delta attempt to belittle the watershed U.S.-Canada Air Transport Agreement, signed on February 24, 1995, as insufficient to justify a grant of antitrust immunity because it does not fit a static formula for an open skies agreement. These claims ignore the reality that the U.S.-Canada agreement, combined with the highly competitive transborder market structure, contains all the critical elements of an open skies agreement, and indeed has created the most competitive international air transportation market that the United States has with any other country in the world.

On the day the agreement was signed in Ottawa, in the presence of President Clinton and Prime Minister Chretien, Secretary Pena stated that "[t]he largest, most open bilateral trading relationship in the world finally has a new cross-border aviation treaty to match it. This breakthrough accord is a free-trade agreement in aviation, giving U.S. and Canadian airlines virtually unlimited access to cities in either country in transborder service.... Today begins a new era, one of stronger trade, more jobs and easier, more convenient travel for millions of our citizens."

A few weeks later, Secretary Pena hailed the agreement as "a huge breakthrough -- even in global terms.... [I]t

has freed up the largest single bilateral aviation market in the world, with more than 13 million cross-border passengers a year." He noted that several U.S. airlines had already filed for broad new authority, and concluded that "[t]hese developments are just the beginning. We confidently expect to see dramatic growth in airline service and travel options that will benefit travelers and airlines in both nations" (speech before the International Aviation Club, Washington, D.C., March 7, 1995.)[1]

Similarly, James J. Blanchard, U.S. Ambassador to Canada, declared that "[t]his Open Skies Agreement gives us the most modern bilateral aviation agreement with Canada than any two countries in the world" (remarks before the Canadian-American Business Council, Washington, D.C., April 4, 1995).

In the January 1996 United States Embassy newsletter, entitled "Open Skies," Ambassador Blanchard stated that "[t]he signing of the Open Skies air agreement during the President's February, 1995 visit was a radical break from the previous almost primitive set of rules governing cross-border air services. * * * Open Skies is meant to benefit people,

[1]In seeking approval for their own code-sharing services, United and Air Canada quoted these same remarks. See Joint Application of United Air Lines and Air Canada, May 31, 1995 (undocketed), pp. 6-7.

businesses, and communities in both the U.S. and Canada. All measures of performance show that we have succeeded. * * * The fact that our two governments could achieve Open Skies, an unattainable goal just two years ago and for over 20 years before, is proof of what a positive, proactive approach can accomplish.... Our respective political leaderships, including President Clinton and Prime Minister Chretien, took up the cause and made Open Skies a top priority."

In testimony before the Senate Commerce, Science and Transportation Committee on July 11, 1995, Secretary Pena stated that "[i]n February, I joined the President to sign our new aviation agreement with Canada. On that day we effectively deregulated the largest single bilateral aviation market in the world.... [I]n the first three months of that new agreement we have seen an estimated 25 percent increase in transborder service, with major benefits to cities, to consumers, and to the economics of both our nations."

In remarks before the Airports Council International-North America in Washington, D.C. on December 7, 1995, Patrick V. Murphy, Deputy Assistant Secretary for Aviation and International Affairs, stated that the U.S.-Canada agreement "effectively deregulated the largest single bilateral aviation market in the world. This agreement has led to an avalanche of applications from both U.S. and Canadian carriers.... Just 8

months after the agreement was signed, U.S. and Canadian airlines have started over 50 new transborder services. This represents an increase in flight frequencies of almost 10%, a phenomenal increase in a major international market which historically averaged an annual increase of just 3%."

In testimony before the Subcommittee on Oversight of the House Ways and Means Committee on March 22, 1995, Mr. Murphy stated that "the Administration has adopted 'Open Skies' initiatives with a number of our trading partners. The most dramatic fruit of this effort was the recent signing in Ottawa of the new U.S.-Canada aviation agreement. That agreement provides for complete 'Open Skies' to be phased in over three years between the U.S. and the Canadian cities of Montreal, Toronto, and Vancouver, and for immediate 'Open Skies' in all other U.S.-Canada markets."

Air Canada -- contrary to the rhetoric in its current pleading -- has not been hesitant to call the February accord an open skies agreement, without qualification. In a speech to the International Aviation Club in Washington, D.C. on June 20, 1995, Hollis L. Harris, Chairman, President and CEO of Air Canada, said this: "[I]n the four months since President Clinton and Prime Minister Chretien signed an open skies agreement, the transborder skies have never been busier. Open skies set the stage for airlines in North America to offer more

transborder flights from virtually any point in the United States to virtually any point in Canada. There's no doubt that the signing of the new Canada-U.S. open skies agreement is the story of the year for this industry. * * * All of us at Air Canada believe we have a lot to offer transborder travellers under open skies and we are confident in our ability to compete even with much larger airlines."

The fact that there is a phase-in period for Vancouver, Montreal, and Toronto,[2] or that for reasons of geography and customer preference the U.S. did not deem it critical to the negotiations to insist on unlimited Fifth Freedom rights, does not mean that the U.S.-Canada agreement establishes any less of a competitive playing field as any open skies agreement in Europe. There is immediate freedom of entry on all transborder routes for carriers of Canada; there is immediate freedom of entry on all routes (subject to the phase-in provisions) for U.S. carriers; and there is immediate and complete pricing freedom for carriers of both sides.

The result has been a dramatic expansion of transborder services. In one year's time, total nonstop frequencies have grown from 1,975 weekly flights to 2,940, an increase of

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[2]The phase-in provisions for Vancouver and Montreal -- which end early next year -- are virtually moot, since all requests by U.S. carriers for new service in 1996 were accommodated.

49 percent. First nonstop service has been added in 55 city-pairs, and first competitive nonstop service has been added in 10 others. As of February 1996, the U.S.-Canada market is served by 32 carriers, and the annual market size is 13 million passengers and growing. This is not only the largest international air transport market in the world, but also the most competitive.

Nonetheless, Delta contends that its application for antitrust immunity with Sabena, Swissair, and Austrian Airlines (Docket OST-95-618) should be granted -- and the American/Canadian application should be denied -- because the United States has entered into paper open skies agreements with Belgium, Switzerland, and Austria. Similarly, Northwest contends that the antitrust immunity it received from the Department in 1993 for its arrangement with KLM is justified because the United States has a paper open skies agreement with the Netherlands, but that immunity for American/Canadian should be withheld because the United States-Canada agreement does not embody every element of an open skies formula. The Department should reject such arguments.

In judging applications for antitrust immunity, the Department should clearly consider substance over form. The undeniable result of the U.S.-Canada agreement is the creation of a genuinely competitive market. The open skies agreements

underlying Delta's and Northwest's respective alliances, on the other hand, have not led to anything remotely resembling a competitive market, as shown in the following chart:

United States to:	Operating Carrier	Frequency Share	Alliance Frequency Share
Austria	Austrian	100%	100%
Belgium	American	30	54
	Delta	15	
	Sabena	39	
	United	15	
Switzerland	American	22	67
	Austrian	8	
	Delta	8	
	Swissair	52	
	United	11	
Netherlands	Delta	14	59
	KLM	42	
	Northwest	17	
	Tower Air	1	
	United	6	
	Fifth Freedom Carriers	20	
Canada			14

The U.S.-Canada market is far more competitive than any of the four country-pair markets in which Delta and Northwest have formed alliances. The combined nonstop transborder frequency share of American and Canadian is 14 percent; Air Canada has the largest single carrier share, at 24.8 percent, followed by 10 carriers with shares ranging from 8.6 to 4.0 percent (Exhibit JA-2). All told, the U.S.-Canada market has 32 nonstop operators.

To be sure, in abstract theory there could be additional entry by U.S. carriers in the Austria, Belgium, Switzerland, and Netherlands markets. But in the real world, significant new service by non-alliance carriers is extremely unlikely, as the Department itself has recognized. See Order 92-11-27, November 18, 1992 (**Northwest/KLM**), p. 16 ("[w]e doubt that any other carrier would be particularly interested in providing nonstop service between Amsterdam and either Detroit or Minneapolis/St. Paul if the applicants charged supra-competitive prices, since no carrier besides Northwest has a hub at either U.S. gateway").

The U.S.-Canada market is fiercely competitive today, and new services are being added by the carriers of both countries. Notwithstanding the assertions from Delta, Northwest, and United that the U.S.-Canada agreement is not a formulaic open skies agreement, the fact is that the American/Canadian arrangement is far more deserving of antitrust immunity than the Delta/Sabena/Swissair/Austrian or the Northwest/KLM pacts in light of marketplace realities.

II. PRESENCE OF AN OPEN SKIES AGREEMENT IS ONLY ONE OF MANY FACTORS TO BE CONSIDERED BY THE DEPARTMENT IN ASSESSING IMMUNITY APPLICATIONS.

Even if the Department were to credit the argument that the U.S.-Canada Air Transport Agreement does not fully match the formula for an open skies agreement, neither the

Department's policy nor the underlying statute establishes open skies as an essential predicate for antitrust immunity.

The relevant statutory provision, 49 USC 41308, authorizes the Department, in its discretion, to exempt carriers from the antitrust laws. Long before code-sharing gained its current popularity, the Department had established its test for granting immunity from the antitrust laws, and that test is properly grounded in the language of the statute. It has been the Department's policy to deny antitrust immunity for agreements that do not violate the antitrust laws unless immunity is required by the public interest and the parties will not proceed without it. Pan American World Airways/Aeroflot, Order 88-8-18, August 10, 1988, p. 9. This test makes no mention of open skies.

In fact, in Pan Am/Aeroflot, the Department granted immunity to a blocked-space agreement between the two carriers in a highly restrictive bilateral environment. The Department concluded that the carriers' arrangement bore a risk of antitrust attack but was nevertheless in the public interest because it "reflects the bilateral contemplation of cooperative marketing programs... and is specifically designed to facilitate the blocked-space service previously approved by the Department" (pp. 5-6). This precedent alone defeats the contention

that the Department has established open skies as a prerequisite for immunity.

The Department's Policy on International Aviation does not establish open skies as a precondition for immunity. In fact, the Department did not even use the term "open skies," but stated instead that one approach is to model future negotiations on the U.S.-Canada agreement:

> "We are launching our new initiatives to create freer trade in aviation services by taking the following steps:
>
> o Renew efforts to achieve liberal agreements with trading partners with which our aviation relationships lag behind those of our general trade advancements, as we have done successfully with Canada" (Statement of United States International Air Transportation Policy, 60 Fed. Reg. 21841, 21844, May 3, 1995).

In his June 9, 1995 speech in Paris, quoted by Air Canada in its pleading (p. 5), Secretary Pena did not state that open skies is a prerequisite for antitrust immunity. He said that immunity would be granted "only where the overall net effect of a transaction for which immunity is sought is pro-competitive and pro-consumer. The existence of an 'open skies' environment, and the elimination of other competitive restrictions, would be important factors in any such consideration" (emphasis supplied).

Nor did the U.S. Government present open skies as an essential precursor for immunity in last year's bilateral

negotiations with Canada. In those negotiations, Canada pressed the question of antitrust immunity several times. While the U.S. declined to address immunity affirmatively in the final bilateral agreement, the U.S. Government never took the position during the negotiations that immunity would be denied to Canadian carriers unless the agreement achieved a formulaic definition of open skies. Instead, the U.S. stated that it would evaluate any proposed agreement for which immunity is sought on its own individual merits. To deny, or even postpone, consideration of the American/Canadian application on the ground that the bilateral agreement fails an open skies test could only be viewed as a reversal of the U.S. Government's position in the negotiations.

The test for antitrust immunity is far more flexible than Delta, Northwest, United, and Air Canada suggest. The test requires a finding of potential antitrust exposure that is outweighed by public benefits. The examination of public benefits requires weighing the pro-competitive benefits against potential anticompetitive harm, and includes the consideration of foreign policy objectives. The Department has properly maintained the needed flexibility in the test for immunity, and has never foreclosed the possibility of immunity without total open skies. The opposing parties have not cited any statement by the Department or the Secretary to support their position.

The Department's procedure for evaluating an immunity application involves the examination of all factors affecting competition in the relevant market, not just the presence or absence of open skies. As one factor in the test for immunity, open skies is undeniably important for its effect on maintaining a competitive environment, particularly within certain markets. In the overwhelming number of cases, countries dealing with the United States have a single dominant flag carrier. In those situations, the requisite pro-competitive and pro-consumer transaction between the dominant foreign carrier and a U.S. carrier is difficult to establish without an open skies agreement. According to Anne Bingaman, Assistant Attorney General for Antitrust, although open skies fosters new entry opportunities, "that does not mean...that open skies are necessarily a complete solution to the loss of competition that can be caused by some hub-to-hub code-share arrangements" (speech before American Bar Association Aviation Forum, Washington, D.C., January 25, 1996). Thus, the simplistic, single-factor test promoted by the commenters must be rejected in favor of careful analysis of the many factors that impact competition.

The Department applied the well-developed test under the Clayton Act to determine whether immunizing the North-

west/KLM cooperative agreement would lead to a reduction in competition:

> "The Clayton Act test requires us to consider whether the agreement will substantially reduce competition by eliminating actual or potential competition between Northwest and KLM so that they would be able to raise prices above competitive levels or reduce service below competitive levels. Under the antitrust laws, if there is no reduction in competition it is irrelevant whether the Agreement will enable the applicants to offer services (or achieve efficiencies) that cannot be matched by other U.S. carriers" (Order 92-11-27, November 16, 1992, p. 13).

Any agreement must be considered in the context of the relevant market structure to understand its impact on competition. In the case of the American/Canadian commercial alliance agreement, the market structure ensures vigorous competition even if the proposed arrangement is immunized. Indeed, far from meeting their burden of proving substantial reduction or elimination of competition,[3] those opposing the application have illustrated that the joint efforts of American and Canadian will promote competition, not harm it.[4]

Upon careful examination of the structural elements of the transborder marketplace, it is apparent that the Ameri-

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[3]See 49 USC 41308; Northwest/KLM, Order 92-11-27, November 16, 1992, p. 12.

[4]For example, Air Canada notes that American and Canadian will "enjoy a significant cost advantage to the extent that they would be able to integrate their sales forces" (p. 8). We agree, and anticipate additional efficiencies that will enhance competition and create the potential for lower fares.

can/Canadian arrangement will be substantially pro-competitive, particularly when contrasted against the market structures in Europe where immunity has been granted and additional applications are pending. Quite simply, because of the U.S.-Canada Air Transport Agreement, the transborder market is the most competitive international market in the world, and there is no relevant market in which the immunized alliance could lead to substantially reduced competition and market power.

The first and most significant structural characteristic of transborder competition is that the presence of two Canadian international carriers -- which can serve any U.S.-Canada city-pairs without any phase-in limits -- ensures competition in all significant transborder city-pairs. In the city-pairs where their service overlaps, American and Canadian face actual competition from Air Canada in New York-Toronto, and from Air Canada and United in Chicago-Toronto.

Toronto is a hub for Air Canada. Chicago is a contested hub for American, where United is stronger. New York is not a hub. Accordingly, the overlapping routes do not suffer the same vertical restraints on access to beyond feed traffic prevalent in other ventures. Further, because the bilateral agreement allows unrestricted open entry for Canadian carriers, there is potential entry by Air Canada to discipline

pricing in any city-pairs that American and Canadian might choose to serve.

In contrast to the genuine competition prevalent under the U.S.-Canada agreement, the Department has recognized the practical limitations of open skies with a country that -- unlike Canada -- has a single international carrier. Even under the open skies agreement with the Netherlands, the Department has conceded that Northwest and KLM would monopolize their hub-to-hub segments from Minneapolis/St. Paul and Detroit to Amsterdam: "We doubt that any other carrier would be particularly interested in providing nonstop service [in either market] if the applicants charged supra-competitive prices, since no carrier besides Northwest has a hub at either U.S. gateway" (Order 92-11-27, p. 16). It is thus clear that blind reliance on open skies as the definitive measure of approving an immunity application is misplaced. In the transborder market, the presence of two airlines in Canada, and strong actual competition at the relevant hubs, more than offsets any competitive concerns arising from the phase-in period, particularly in light of Air Canada's unquestioned strength and dominance vis-a-vis Canadian, as discussed below.

In addition to the presence of two carriers, there is a lengthy list of other structural factors that facilitate competition in the U.S.-Canada transborder market but are not

present in U.S.-Europe markets. For example, geography is an important factor. Any carrier can operate the short transborder routes to Canada's key population centers, and high-frequency point-to-point operations may be viable. Transborder service does not require sophisticated and expensive over-water aircraft. In fact, many key routes can be flown with turboprop equipment. Thus, transborder competition is greater because important barriers to entry in U.S.-Europe markets are clearly absent.

Other barriers to entry, typical of some European routes, are also absent here. For example, Canada has no slot-constrained airports, has no airports with other significant facility constraints, and has no doing-business limitations such as restrictive ground-handling regulations. Nationalistic buying habits, often a barrier to U.S. airlines operating abroad, are not a factor in the U.S.-Canada market due to geography, cultural similarities, and a long-established trade relationship.

Structural elements which may facilitate collusion in U.S.-Europe markets are absent as well. Most importantly, there is no IATA passenger tariff coordinating conference -- and indeed never has been one -- for the transborder market. In addition, operating under the Department of Justice consent decree in United States v. ATPCO, 1994 U.S. Dist. LEXIS 11904,

August 10, 1994, the Airline Tariff Publishing Company has ceased processing first ticket dates for transborder fares, thus eliminating the use of advance announcement of fares cited as a facilitating practice by the Justice Department.

Further, United and Air Canada tacitly concede that the American/Canadian arrangement, even including their regional carriers, will not exercise market power. Each makes the point that Air Canada's 25 percent share of transborder frequencies could not result in market power. Without accepting that view, it must necessarily follow that American and Canadian -- with a combined 14 percent share -- do not have market power.[5]

Another telling statistic, not available when the initial application was filed last November, is the relative share of transborder bookings. In 1995, Air Canada had a 31.8 percent share of transborder bookings in SABRE,[6] compared to 9.4 percent for Canadian. Moreover, the trend is ominous. Air

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[5] Air Canada erroneously states that by including regional affiliates in the comparison, American/Canadian would have a transborder frequency share of 18.3 percent, compared to 24.8 percent for Air Canada (p. 14). In fact, the 24.8 percent figure, as shown in Exhibit JA-2, reflects only Air Canada's service. When the transborder frequencies for its regional affiliates (Air Ontario, Air BC, Air Alliance, and Air Nova) are included, Air Canada's share increases to 33.9 percent.

[6] Full data for major CRS systems (CONCRS) is available for July 1995 and thereafter. SABRE has reconstructed historical booking data for periods prior to that time.

Canada gained 3.5 percentage points from 1994 to 1995, compared to Canadian's 1.9 point increase. Thus, Air Canada's presence in the transborder market is extensive and growing.

Finally, Air Canada has established its own code-sharing ventures with both United and Continental. Thus, the scenario is just as forecast by the Department and its consultant, Gellman Research Associates (GRA), in connection with the International Aviation Policy Statement. The transborder market is moving toward fierce competition between networks, where significant city-pairs may attract point-to-point service as well. The fact that these alliances are efficiency-enhancing, particularly where immunity allows greater integration, led GRA to conclude that such a market structure would be pro-competitive:

> "The fact that competition can be maintained or increased with a small number of networks means that if industry consolidation occurs, it need not be anti-competitive. Furthermore, the building of large international networks could in some cases increase domestic competition by strengthening carriers that otherwise might exit markets. The increased competition that can occur because of international code-sharing should be beneficial to the U.S." (Gellman Research Associates, A Study of International Code-Sharing, December 1994, p. 123).

This is precisely the case with American and Canadian. By strengthening Canadian in certain routes, immunizing the American/Canadian commercial alliance will be highly pro-

competitive, allowing Canadian to enter and remain in city-pairs it may otherwise have had to cede to the dominant Air Canada.

III. THERE IS NO BASIS FOR DEFERRING ACTION ON THE AMERICAN/CANADIAN APPLICATION SIMPLY BECAUSE UNITED AND AIR CANADA REMAIN UNDECIDED ON WHETHER TO SEEK ANTITRUST IMMUNITY FOR THEMSELVES.

United asserts that "due process and fundamental fairness dictate that the Department notify other carriers of its intent to proceed and set a procedural schedule for the filing of other applications, which would be considered simultaneously" (p. 6). United's position is without merit. If United is itself interested in seeking antitrust immunity, it is free to file an application at any time. The Docket Branch is open each business day from 9 am to 5 pm, and nothing is preventing United from offering its own application for comments by interested parties and consideration by the Department.

The Ashbacker principles cited by United (pp. 7-8) have no pertinence here, especially since United has declined to request immunity for itself. It is well established that the Department is not obligated to delay the processing or approval of one carrier's application simply because another carrier states that it may be interested in a similar opportunity but does not perfect its interest by filing its own application. See, e.g., American Airlines, Chicaso-Milan/Rome

Authority, Order 89-11-27, November 14, 1989, p. 5 (dismissing challenges to the grant of authority where "[a]t the time American's Chicago-Italy exemption application was granted, American was the only applicant"); Flying Tiger Transpacific Renewal Case, 75 CAB 107, 108 (1977) (rejecting United's Ashbacker arguments where it had failed to file a competing application); Airlift International, 62 CAB 341, 342 (1973) (by failing to seek consolidation of its application, Eastern "waived any Ashbacker rights which it might arguably have possessed").

The Department's consideration of the American/ Canadian joint application should not be brought to a stand-still simply because United apparently wants more time to sort out its own potential relationships with other carriers. United's empty assertions about "due process," "fundamental fairness," and Ashbacker should be rejected.

IV. EVEN IF AIR CANADA HAD STANDING IN THIS PROCEEDING, ITS ARGUMENTS CLAIMING ENTITLEMENT TO A "HEAD START," AND DENYING ITS DOMINANCE OF THE TRANSBORDER MARKET, ARE WITHOUT MERIT.

Air Canada, as a foreign carrier, has no standing to submit comments to the Department to offer advice on U.S. aviation policy. But even if it had standing in this proceeding, Air Canada's arguments are baseless. First, Air Canada complains that the bilateral was intended to offer it a "head start' over U.S. competitors, and that immunizing the American/

Canadian commercial alliance would rob it of that advantage. Air Canada already has a decades-long head start in the trans-border market because, until 1989, Air Canada was wholly owned by the Canadian Government, which favored Air Canada in trans-border route awards. In addition, until the new bilateral agreement was reached, entry into the transborder market from either side of the border was strictly limited. Air Canada undoubtedly expected the bilateral agreement's head start to be its exclusive franchise, because Canadian cannot match Air Canada's financial strength to take full advantage of the new competitive opportunities. Indeed, Air Canada has launched a much-publicized aircraft purchase program and dramatically expanded its transborder service, targeting 20 new routes in 18 months.

In contrast, Canadian's financial situation bars it from keeping pace with Air Canada's expansion, so it has pursued an alternative business strategy. Canadian has entered into a commercial alliance with American in order to utilize the agreement's opportunities. By its alliance with American, Canadian can begin new transborder services and increase frequencies without incurring prohibitive marketing and operational start-up costs.

Although the alliance of American and Canadian is far smaller than Air Canada in the transborder market, the alliance

plays an essential role in enhancing U.S.-Canada competition during and beyond the phase-in period. The bilateral agreement created new slots at New York LaGuardia and Chicago O'Hare airports for use by Canadian-flag carriers. Under the alliance, Canadian has initiated new nonstop service in the New York-Toronto and Chicago-Toronto city-pairs, thereby utilizing slots which would otherwise have been assigned to Air Canada. So long as American and Canadian can fully coordinate activities on those and other routes, they will maintain a pro-competitive and pro-consumer alternative to Air Canada.

Despite Air Canada's efforts to conceal its market dominance behind a smoke screen of irrelevant comparisons, the truth remains that there is a genuine danger that Air Canada will continue to dominate transborder service -- likely the broadest relevant market considered by the Department. Nearly one in every three bookings made for transborder travel is made on Air Canada, and its share is growing.

Air Canada has made plain its intention to eliminate Canadian as an impediment to its dominance of the transborder market. For example, in October 1995, Hollis L. Harris, Air Canada's President, Chairman, and CEO was quoted as saying, "We have 5 million frequent flyers in California. We're going to squeeze Canadian out of the market." Travel Weekly, October 30, 1995, p. 20. The February 1996 issue of Airline Business

states that Robert Milton, Air Canada's Senior Vice President for Marketing and Inflight Service, calls Air Canada dominant east of Saskatchewan, and hopes that a drive in western Canada -- home to Canadian -- will increase its market share to 50 percent by the end of 1997 from its present 30 percent. This article also states that "[f]rom eight scheduled routes to the U.S. in March 1995, prior to open skies, [Air Canada] will be serving 30 one year on -- surpassing its original target of 20. * * * The carrier aims to double its transborder revenues from C$640 million (US$463 million) as of March 1995 to C$1.2 billion by March 1998."

Canadian believes that the best means for presenting a competitive challenge to Air Canada is with the help of American's marketing expertise. Immunizing the American/Canadian commercial alliance will give Canadian an opportunity to do so, maintaining and enhancing competition for the benefit of consumers on both sides of the border.

V. IF GRANTING THE AMERICAN/CANADIAN APPLICATION LEADS OTHER COUNTRIES TO ENTER INTO AVIATION AGREEMENTS SIMILAR TO THE U.S.-CANADA AGREEMENT, THAT WOULD BE A SIGNAL ACHIEVEMENT FOR U.S. AVIATION POLICY.

Northwest argues that granting the American/Canadian joint application "would send a message to this nation's trading partners that they need not open their skies as a prerequisite to securing antitrust immunity," and that such an

outcome "would eviscerate the very fabric of the Department's 1995 International Policy Statement" (p. 5). Similarly, Delta asserts that the Department "would be...sending foreign governments precisely the wrong message" about "liberaliz[ing] their aviation regimes" (p. 4).

These arguments are without basis. As shown above, the U.S.-Canada open skies agreement is a watershed achievement in creating the most competitive international air transportation market in the world. If the U.S. Government could accomplish anything remotely akin to the U.S.-Canada aviation environment with Japan, or with our major trading partners in Europe such as Britain, France, or Italy, such agreements would rank among the most significant in the history of bilateralism. Far from sending foreign governments the "wrong message," approval of the American/Canadian agreement would send precisely the risht message. If foreign governments expect antitrust immunity for their carriers that enter into commercial arrangements with U.S. carriers, they must enter into open skies agreements that provide a level of competition similar to that in the U.S.-Canada market.

Achievement of the breakthrough U.S.-Canada bilateral agreement provided a practical approach to what had been an intractable problem. Many countries simply will not be able to make an overnight switch from a restrictive regime to full open

skies. Accordingly, the phase-in period in the U.S.-Canada agreement serves the U.S. Government's goal of achieving open skies. The Department recognized this sound practical approach in the International Aviation Policy Statement:

> "Transitional asreements - Under this approach, we would agree to a specified phased removal of restrictions and liberalization of the air service market. This approach contemplates that both sides would agree, from the beginning, to a completely liberalized air service regime that would come into effect at the end of a certain period of time" (60 Fed. Reg. 21841, 21845, May 3, 1995).

An agreement which achieves the goal of open skies in a fixed period is just as deserving of the benefits of immunity as an immediate open skies agreement, so long as the other tests for immunity are met, as they are here.

VI. THE ISSUES RAISED BY IATA ARE NOT RELEVANT IN THIS PROCEEDING.

In its comments, IATA requests that the Department refrain from considering in this docket the question of whether approval of the American/Canadian application should affect the right of the applicant carriers to participate in IATA tariff coordination.

As the joint applicants stated in their application, U.S.-Canada markets have never been included in IATA tariff coordination activities. Moreover, American voluntarily and unilaterally withdrew from the IATA passenger tariff coordinating conference in late 1994; American's action was effective

immediately, and was formally recognized by IATA effective January 1, 1996 (p. 55).

In these circumstances, the Department's approval of this application will have no impact on any IATA activities with respect to the transborder market. The issues raised by IATA in its comments are not relevant in this proceeding.

CONCLUSION

For the foregoing reasons, the Department should promptly approve, and grant antitrust immunity to, the proposed commercial alliance agreement between American Airlines, Inc. and Canadian Airlines International Ltd.

Respectfully submitted,

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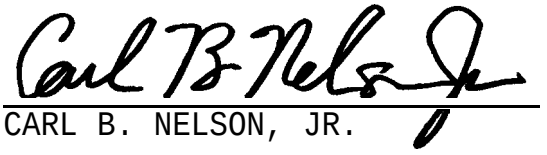
February 15, 1996

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document by fax or first-class mail on all persons named on the service list attached to the joint application.



CARL B. NELSON, JR.

February 15, 1996